DRN-4771444

The complaint

R – a business – is unhappy that Zurich Insurance Plc reduced the amount it paid for a claim R made on its commercial property insurance policy following damage caused by a storm.

What happened

The details of this complaint are well known to both parties, so I will not repeat them again in detail here. But to briefly summarise, R's property is made up of several buildings, two of which were damaged by a storm in November 2021. Storm is a peril covered under the policy, so R made a claim to Zurich. Following investigations, Zurich said the property was underinsured. It valued the cost of rebuilding the property at around £305,000 but R had insured it for only £209,345.85 at the time of the loss.

Zurich accepted the claim was covered under the terms of the policy. But because the property was underinsured, it said the claim would be settled proportionately. Zurich said the policy terms allowed it to reduce the settlement based on the proportion of the sum insured against what it says the sums insured should have been.

R isn't happy with this, and disputes it was underinsured. R also complains that Zurich failed to deal with its claim for business interruption and with the premium refund it received. R also questioned the level of commission it was charged by the broker.

Our investigator considered the complaint. She felt Zurich's approach of proportionately reducing the settlement was fair, taking into account the specific wording of R's policy. She said Zurich was willing to deal with the business interruption claim, but R had refused to provide the necessary information required for validation, and so it wasn't unfair that Zurich hadn't yet dealt with it. She also shared how Zurich had calculated the premium refund and said it hadn't made any errors. And finally, she explained that this complaint was only considering the actions of Zurich, not the broker, and so we couldn't answer R's complaint about the commission as part of this complaint. She said we could set up a separate complaint about the broker if R wished to pursue this.

Zurich accepted our investigator's findings, but R didn't. So, as no agreement could be reached, the complaint was passed to me to decide.

I was minded to reach the same overall outcome as our investigator, but for different reasons. So, I issued a provisional decision to give the parties the opportunity to respond, before I reached my final decision. Here's what I said:

> ***"What I've provisionally decided – and why***
>
> *I've considered all the available evidence and arguments to decide what is fair and reasonable in the circumstances of this complaint.*

The primary issue I need to decide here is whether it is fair for Zurich to proportionately reduce the settlement of R's claim, in the way that it has. I'll then also consider R's concerns about the business interruption claim and the premium refund. But like our investigator, I'll not comment on the commission charged by the broker – for the same reasons given by our investigator.

Based on everything I've seen, I agree that Zurich can fairly and reasonably reduce the settlement R is due.

I don't agree that the method Zurich has used to arrive at its proportionate reduction is fair or reasonable. But even if it had applied a fair calculation, I think the end result would have been the same. So, overall, I'm not intending to direct Zurich to increase the claim settlement amount. I'll explain why in more detail below.

Why it is fair to proportionately reduce the settlement

R is a commercial customer. This means the relevant law which applies is the Insurance Act 2015 (the Act). This states that R was required to make a fair presentation of the risk to Zurich. That meant disclosing any material information R knew, or ought to have known. And particularly relevant to this complaint, it meant providing a reasonable estimate of the cost of rebuilding the property.

I've thought carefully about all the evidence and arguments provided regarding the alleged underinsurance. I'd first acknowledge that arriving at a sums insured figure isn't an exact science, and ultimately R wasn't required to provide the "correct" figure, only a reasonable estimate made in good faith.

R has explained that the sums insured figure it provided was based on a calculation of there being 1,398 square meters (m²) of buildings on site which were being insured, which works out at almost £150/m² based on the sums insured it provided. But R hasn't provided any evidence to explain how it decided that £150/m² was adequate at the time this figure was provided – for example a surveyor's estimate, or evidence of use of an online rebuild cost tool. So, in the absence of some sort of basis for the figure R provided, I don't think I can fairly conclude that it provided a reasonable estimate of the rebuild costs when taking out the policy.

R has specifically questioned how Zurich can be saying the buildings at its property should have been insured for a total of £305,000, which it says equates to £218/m², and yet be seeking to settle the claim for the damaged building for £28,532 which equates to £121/m². R argues that both cannot be correct.

I've seen a breakdown of Zurich's calculations which are detailed. And as they were produced by someone with expertise in this field, I consider them more likely to represent the accurate rebuild costs than the estimate put forward by R, which as I say appears not to have any particular basis. These breakdowns include separate rebuild costs (including the cost per m² for each of the separate structures), based on the differences in materials used in the construction of each structure. I find this logical and persuasive, and that it explains how the overall cost per m² for the site would be significantly higher than the settlement cost paid for the particular structure in question.

Based on all the above, I'm persuaded that R breached the duty of fair presentation when providing its estimate of the rebuild cost.

Why the proportionate reduction method applied by Zurich is unfair

The Insurance Act 2015 sets out the remedies available to Zurich if R breached the duty of fair presentation. For deliberate or reckless breaches, the Act entitles Zurich to avoid the policy and decline all claims. But here Zurich has accepted the claim, so it clearly hasn't treated it as though R made a deliberate or reckless breach.

For all other breaches, the remedy available to Zurich depends on what it would have done had a fair presentation been made. If Zurich would have offered the policy for a higher premium, the Act says it may reduce the claim settlement proportionately – based on the amount of premium paid compared to the higher premium it would have charged had the breach not occurred.

Instead of following the remedy set out in the Act, Zurich sought to proportionately reduce the settlement based on the difference between R's estimate of the sums insured, and the reinstatement cost estimate calculated by its loss adjuster – which I've already explained I consider to be more persuasive than R's estimate, given the loss adjuster's expertise and the breakdown of their calculations. Zurich says this is in line with its policy wording, which states:

> *"Section Conditions*
> *2. Application of Average Sums*
>
> *Insured in respect of Property or Buildings are declared to be subject to the Application of Average. If the Property or Buildings insured thereby shall, at the breaking out of any fire or at the commencement of any destruction or Damage to such Property or Buildings by any other Peril hereby insured against, be of greater value than such sum insured, then You shall be considered as being Your own insurer for the difference and bear a rateable proportion of the Loss accordingly.*
>
> *For the avoidance of doubt solely in respect of the application of Average to any item under this Policy clause c) iii) of General Policy Condition 1 – Fair Presentation of the Risk will not apply."*

I should also explain here that policy clause c) iii) of General Policy Condition 1 – Fair Presentation of the Risk (mentioned above), is in itself a departure from the Act, because instead of setting out the remedy of proportionately reducing the settlement based on the premiums paid against the premiums which ought to have been paid, this states that Zurich will:

> *iii) if We would have charged You a higher premium for providing the cover We will charge You the additional premium which You must pay in full.*

While the approach Zurich has taken in this case is in line with the policy terms, it's clear it is out of line with the remedies set out in the Act. However, the Act does allow insurers to 'contract out' of its requirements, so long as certain requirements are met. 'Contracting out' means to apply a term, or terms, which would put the customer in a worse position than they would be if the insurer had followed the Act. But in order for an insurer to contract out, it must meet the following requirements:

> *"17 The transparency requirements*
> *..*

(2) The insurer must take sufficient steps to draw the disadvantageous term to the insured's attention before the contract is entered into or the variation agreed.

(3) The disadvantageous term must be clear and unambiguous as to its effect.
…"

I've thought carefully about the relevant policy terms and the transparency requirements for contracting out of the Insurance Act. In doing so, I've also considered a report jointly produced by the Law Commission and Scottish Law Commission, in 2014, covering insurance contract law – which gives additional clarity on the intention of the Act and how contracting out should reasonably be applied.

Chapter 29, page 303, explains the aim behind the Act. Starting at 29.16 it says, in summary:

- *The Act covers a wide range of risks from micro-businesses, SMEs, through to multinational corporations and reinsurance.*
- *Businesses as big as SME may not fully understand the implication of contracting out and rarely would they enter into lengthy negotiations or use lawyers to check such terms.*
- *It imagines contracting out to be widespread in 'sophisticated' markets but not with smaller business customers.*
- *With all this in mind, at 29.29 it sought to discourage insurers contracting out by default in general insurance and, if they did contract out, to ensure policyholders could make an informed decision by bringing the contracted out term to their attention.*
- *29.36 says insurers should think carefully about how they present information, particularly to what it called 'quasi consumers'.*
- *29.50 noted the Act requires the consequences of the term to be clear and unambiguous and gives an example of just how explicit it expects an insurer to be.*

I've kept the above in mind when thinking about whether Zurich has sufficiently, and fairly and reasonably, contracted out of the requirements of the Act, and so can fairly apply its average clause in place of the relevant remedy.

I've also considered the arguments Zurich has put forward to support its application of 'average' instead of the remedies of the Act. I've thought about the terms of the policy and whether, in isolation, they meet the transparency requirements. When read in conjunction, I think it could be argued that the policy terms do explain that average will be applied where the sums insured are inadequate, and that Zurich will not apply clause c) iii) in these circumstances either. But this doesn't, in my view, satisfy the transparency requirements.

I say this because the various relevant terms, which all need to be read in conjunction in order to understand their meaning and applications, are split between pages 18 and 38 of a 178-page policy booklet. So, even if I were to conclude that they were clear and unambiguous to their effect – which I'm not necessarily saying I do – I don't agree that they have been sufficiently drawn to the insured's attention.

Zurich has argued that it sent a new business letter, together with the policy booklet, which sufficiently drew its departure from the Act to R's attention. This letter stated:

> *"Important - You must make a fair presentation of the risk to us at inception, renewal and variation of your policy. This means that we must be told about all facts and circumstances which may be material to the risks covered by the policy including but not limited to the information detailed within the statement of facts and that any material facts must not be misrepresented. A material fact is one which would influence the acceptance or assessment of the risk. If you have any doubt about facts considered material, it is in your interests to disclose them to us.*
>
> *This policy incorporates a modification to the Insurance Act 2015 whereby, in cases of non-disclosure or misrepresentation which are neither deliberate nor reckless, if we would have charged an additional premium had we known the relevant facts, we will charge that premium and pay any claims in full. In most circumstances this should result in better outcomes for you when compared with the position under the Act which is to reduce claims payments in proportion to the amount of premium that would have been charged. Such modification does not affect Zurich's right to apply the other remedies available under the Act for non-disclosure or misrepresentation where appropriate."*

I accept this document sets out prominently that it contains important information. I also accept that it sets out that Zurich will depart from the remedies of Act. But in my view, it wouldn't be fair to consider that this adequately meets the transparency requirements in relation to Zurich's application of its average clause in this case.

I say this because the new business letter only explains that Zurich will depart from the Act by allowing policyholders to pay a premium shortfall in exchange for a full claim settlement, where there has been a breach of the Act. This is a departure from the Act which is likely to be in the insured's favour, rather than being detrimental. But the new business letter does not explain, or allude, to the fact that where the buildings sums insured are inadequate, Zurich will apply its average clause in place of the remedies of the Act. So, I don't think this satisfies the transparency requirements, as the consequences of Zurich's departure from the Act are not clear and unambiguous as to the effect of the application of average in these circumstances.

So, taking all of that into account, I don't think it would be fair or reasonable to conclude that Zurich has adequately contracted out of the requirements of the Act. And this means my provisional decision is that Zurich's application of its average clause is unfair and unreasonable in the circumstances.

Why the claim position is ultimately the same

As I mentioned at the start of this section of my provisional decision, despite being unfair, I don't think Zurich's application of its average clause has resulted in any detriment to R. I say this because the relevant remedy available in the Act allows Zurich to proportionately reduce the claim settlement based on the difference between the premium it charged, and the premium it would have charged had the sums insured been adequate. And in this case, based on the information and premium calculations Zurich has supplied, a proportionate reduction calculated in this way would have resulted in the same percentage of the claim settlement being paid, as the one it arrived at using its average clause.

Zurich based its settlement on the difference between the sums insured declared and the £305,000 it says should have been declared. This meant it offered 68.7% of the total settlement cost. Zurich says R paid premiums of £182.45 based on the sums insured declared. Had the sums insured been given as £305,000, the premium it would have charged would have been £265.35. This means, following the remedy in the act would also result in a proportionate settlement of 68.7%.

So, despite my provisional decision being that it was unfair for Zurich to apply its average clause, doing so hasn't caused R any detriment, (in comparison to if it had applied the Act) and so there is nothing I think it needs to do to put things right in this particular case. Zurich may however wish to consider what I've said about its application of average in place of the Insurance Act, in future complaints about similar issues.

Business interruption claim

R has also complained that Zurich has refused to settle a claim it made under the Business Interruption (BI) section of the policy for the forced reduction of its livestock due to the damage caused to the building in question. But from what I've seen Zurich hasn't refused to deal with the claim. Rather, it has asked R to provide various pieces of information in order to validate the loss and consider the claim. This included information on the movement its livestock over a 24-month period as well R's last set of accounts.

I understand R feels that some of the information Zurich has requested is confidential. But under the terms of the policy, R is required to provide Zurich with any evidence it requests in support of a claim:

> *"On the happening of any event giving rise or likely to give rise to a claim under this Policy, You must immediately provide details to Us of such and supply all such details and evidence, documentary or otherwise, and shall carry out such things as We may reasonably require."*

The policy also explains that Zurich will handle personal information in line with the requirements of the relevant legislation, and explains that failure to provide it could impact its ability to assess claims:

> *"What happens if you fail to provide your personal information to us*
> *If you do not provide us with your personal information, we will not be able to provide you with a contract or assess future claims for the service you have requested."*

I think the information Zurich has asked for is reasonable given its need to assess and validate the claim. So, I don't think its refusal to accept the BI claim up to now has been unfair or unreasonable in the circumstances.

Zurich has confirmed that should R provide the information it has requested; the BI claim will be considered further. I think this is fair and reasonable.

Should R decide to share the information with Zurich, and a later dispute arise over any proposed settlement, this will need to be raised as a new complaint at that time, and with Zurich in the first instance.

Premium refund

Part of R's complaint initially included a lack of understanding as to how Zurich had calculated the refund of premiums it received after the policy was cancelled in November 2022.

The policy terms and conditions explain how Zurich will handle the premiums where a policy has been cancelled:

> *"If a claim payment has been made or a claim has been submitted or there has been an incident likely to give rise to a claim during the current Period of Insurance, We reserve the right not to refund any premium for the unexpired portion of the Policy. Where a claim has been submitted after the policy has been cancelled, We will deduct the amount of any premium returned to You following the cancellation from any claim payment We may make to You."*

Our investigator has already set out Zurich's calculations of this for R, which were quoted on Zurich's final response letter from March 2023. For completeness I've included them again below.

> *"Renewal premium - £7,437.43. This included a returned premium of £387 Revised renewal premium - £7,050.43*
>
> *Policy on cover for 225 days (31.03.22 to 10.11.22) - £7,050.43 / 365 days x 225 days = £4,346.16*
>
> *Balance outstanding - £2,704.27 (£7,050.43 - £4,346.16)*
>
> *The finance company (Close Brothers) have recovered £1,420.73 following cancellation of the finance agreement with a balance of refund due to you of £1,283.52 (£2,704.52 - £1420.73)."*

Based on the above term, I'm of the view that Zurich's refund of premiums was in line with the terms and conditions.

However, looking at the above calculations, it doesn't appear to have been calculated correctly. I say this because the final reduction stated (£2,704.52 - £1,420.73) doesn't equal £1,283.52 as stated, rather it equals £1,283.79. It also doesn't appear that £2,704.52 was the correct figure to be used. Based on the stated 'balance outstanding' above, the amount the finance company's reduction should have been deducted from was £2,704.27. This would mean a final refund of £1,283.54, rather than £1,283.52.

Given the loss resulting from this discrepancy is exceptionally minor, I don't imagine it's particularly important to R. So, I'm not currently intending to specifically direct Zurich to reimburse the two pence difference. However, strictly speaking, I think this is money that R is entitled to. So, should R wish for me to direct Zurich to reimburse it, plus statutory interest for the time R has been out of pocket, it should let me know in response to this provisional decision, and I will do so in my final decision."

I asked both sides to send me any further comments or evidence they wanted me to consider before I reached my final decision.

Zurich responded to say it didn't have any further comments or evidence it wanted to provide.

R responded to explain why it didn't agree with my provisional findings. It also provided additional evidence, in the form of a quote for rebuilding a larger building on the site of the damaged one, which R said proves it could have been rebuilt for £150/m². Based on this, R says it was not underinsured. To summarise R's other points, it said:

- The original sums insured figures were provided by the broker in 2019, prior to COVID, and then increased by the retail price index (RPI) in 2020 and 2021.

- R is based in a rural area, and building the same type of building in the South East of England would no doubt cost substantially more, and it suspects would influence the reliability of rebuild costs estimation tools.

- Zurich's position is illogical as they are on the one hand saying he should have insured the buildings for £218/m², yet on the other saying he could rebuild the damaged building for only £121/m².

- R didn't receive the new business letter I referred to in my provisional decision.

- Zurich initially attempted to say R wasn't covered for business interruption until R proved otherwise. R feels Zurich were always trying to avoid paying this part of the claim. R would reluctantly share its accounts if it thought there was a reasonable chance of Zurich paying out, but the accounts requested wouldn't have been available at the time they were requested anyway.

- If Zurich has no intention of paying out on such claims, it is fraudulent for it to sell that cover.

- I've misunderstood the concern with the refund of premium. R says Zurich has not refunded £1,283.52, rather it has refused to pay any refund of premium at all.

What I've decided – and why

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

I've also carefully considered the responses to my provisional decision. Having done so, my overall conclusions remain the same as outlined in my provisional decision. But I will be directing Zurich to pay R the outstanding premium refund. I'll explain why.

Underinsurance

I've thought carefully about R's additional comments and evidence on this point. But based on all the available evidence, I remain of the view that it was fair for Zurich to consider R was underinsured and I think it's fair for it to apply a proportionate approach to settlement of the claim – in line with what I explained in my provisional decision.

I say this because responsibility for providing a reasonable estimate of the sums insured rests with R, not the broker. And by its own admission, no further inspections of the buildings took place following 2019. I'm also mindful that the rising cost of building materials between 2021 and 2022 was well publicised and so a standard RPI increase on a previously declared figure would be unlikely to be sufficient. So, I remain of the view that the sums insured provided at the renewal prior to the storm was made without sufficient reasonable basis.

R has reiterated its concerns about the discrepancy between the cost per square meter to replace the building. But I explained the reason for this discrepancy in my provisional decision. Just because Zurich's estimate suggests the site as a whole ought to have been insured for a sum closer to £218/m², doesn't mean its illogical to say that the building in question could be rebuilt for around £121/m² as each building on the site would likely cost a different amount per square meter to rebuild, depending on its size and the materials used in its construction.

I've considered the quotation R has provided for the larger building, which was also provided to and considered by Zurich.

Zurich has explained that the larger building R was quoted for would benefit from economies of scale – where the larger the building, the less the cost per square meter will be – something R has also pointed to itself. Zurich also highlights that R's estimate doesn't include costs for demolition, which it says could alone add a further £50/m². Zurich explained that its calculation of the value at risk was based on a modern materials basis, and the rebuild cost of each of the buildings on the site would vary given the differences in their construction.

I've thought carefully about everything both sides have said about this point. Having done so, I remain persuaded that Zurich's estimate of the rebuild costs, based on the calculations provided by its loss adjuster, remain the most persuasive evidence currently available as the to the rebuild cost of the buildings on site. And based on this, I think it's fair to conclude that R was underinsured.

That said, Zurich has reiterated that R still has the option to obtain and present its own independent, surveyor's valuation which it will consider further if provided. I think this is fair.

Business interruption claim

I understand R is concerned that Zurich doesn't intend to cover the business interruption (BI) claim, because it initially, mistakenly, said R wasn't covered. But Zurich has since confirmed cover, and explained it is prepared to consider the claim subject to R providing evidence of its losses.

I explained in my provisional decision why I felt the evidence R requested was reasonable in the circumstances. And nothing R has said in response to my provisional decision has changed my conclusions here. So, if R wishes to proceed with its BI claim, it should provide the relevant evidence to Zurich for review.

Should R decide to share the information with Zurich, and a later dispute arises over any proposed settlement, this will need to be raised as a new complaint at that time, and with Zurich in the first instance.

Premium refund

R says I was mistakenly under the impression that Zurich had paid it a premium refund of £1,283.52. R says it refused to pay any premium refund.

I've checked this with Zurich, and it says it couldn't find any evidence of it refusing to pay the refund. Instead, it says it confirmed to the broker that a refund of £1,283.52 would be paid. Zurich says this amount has been on the table since it was first calculated, but R's broker hasn't requested it. However, to acknowledge the delay in R receiving money it was due, Zurich has said it will pay R the correct refund figure of £1,283.54 (as per my provisional decision) plus 8% simple interest on that amount from the date the refund was first calculated – 10 November 2022 – to the date R receives the payment.

The above is in line with what I would likely have recommended Zurich do, given the length of time R has been without funds it was entitled to. So, as Zurich has already made a fair offer here, I'll be directing it to pay the amount is has offered.

Zurich has asked that R confirms whether the refund should be paid directly, or through the broker. And if the former, R should contact Zurich to provide its bank details for the refund to be made.

My final decision

Zurich Insurance Plc has made an offer to pay R £1,283.54 plus 8% simple interest*, from 10 November 2022 to the date of settlement, to settle this complaint and I think this offer is fair in all the circumstances.

So, my decision is that Zurich Insurance Plc should pay R £1,283.54 plus 8% simple interest*, from 10 November 2022 to the date of settlement.

Under the rules of the Financial Ombudsman Service, I'm required to ask R to accept or reject my decision before 28 May 2024.

> **If Zurich Insurance Plc considers that it's required by HM Revenue & Customs to deduct income tax from that interest, it should tell R how much it's taken off. It should also give R a tax deduction certificate if it asks for one, so it can reclaim the tax from HM Revenue & Customs if appropriate.*

Adam Golding
Ombudsman